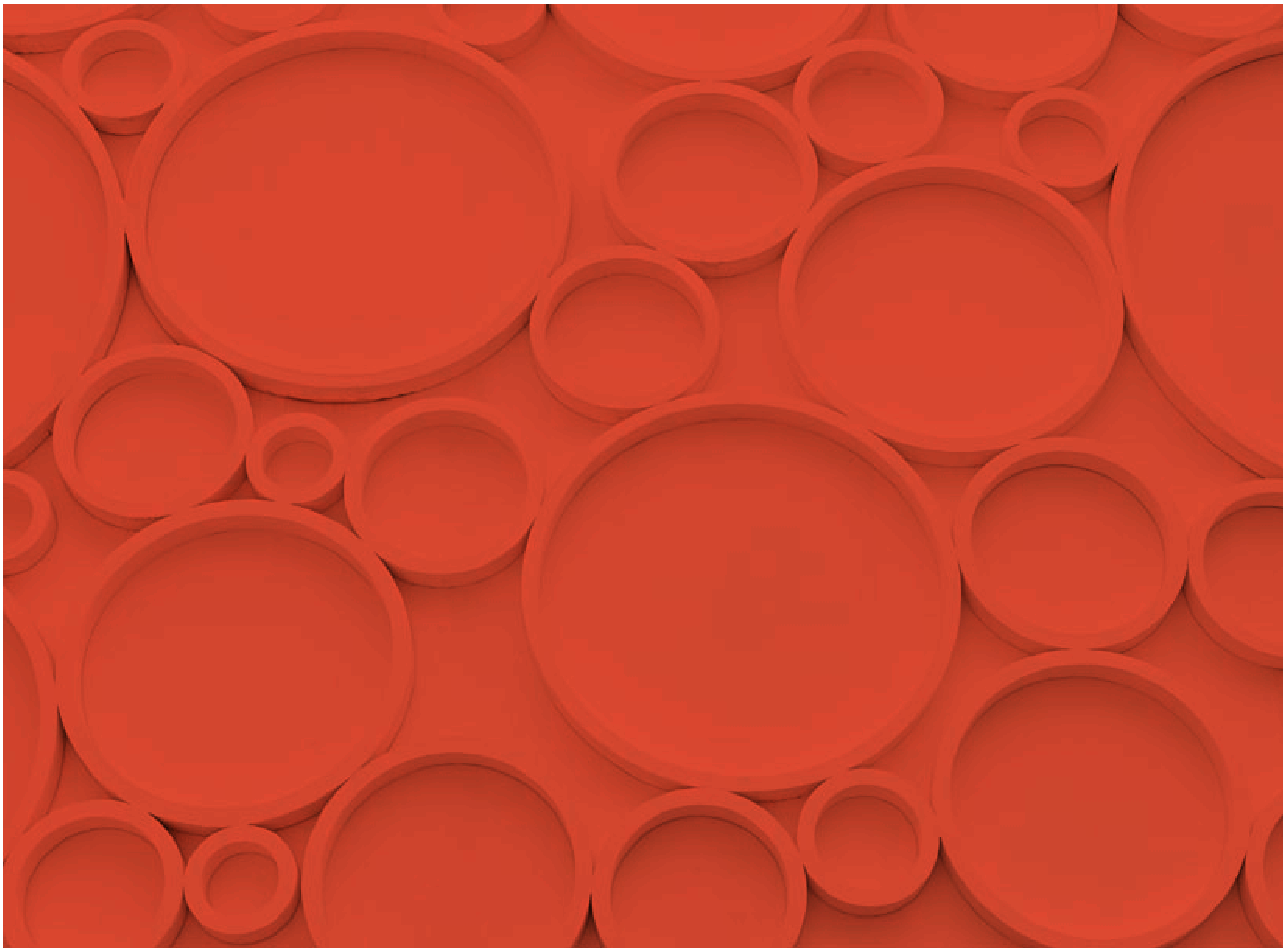
ACCA

ACCA's position on the European Commission's proposal for a revised shareholder rights directive



About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

ACCA was founded in 1904 and is a leading global professional accountancy body with 170,000 members, over 100,000 in EU countries, and 436,000 students in 180 countries. We actively champion effective corporate governance principles and contribute to finance regulation and best practice in Europe and around the world. ACCA works to achieve and promote the highest professional, ethical and governance standards, and advance the public interest. ACCA's members are involved in running many of the world's leading international companies and apply these principles successfully on a daily basis..

ABOUT ACCA'S GLOBAL FORUMS

To further its work, ACCA has developed an innovative programme of global forums which bring together respected thinkers from the wider profession and academia around the world.

Global Forum for Governance, Risk and Performance
The Forum investigates the drivers of business and financial behaviour, exploring ways that risk can be managed to ensure that sustainable and long-term business objectives are not sacrificed for short-term financial performance. The Forum focuses, in particular, on the 'for-profit' private sector and those larger corporations and financial services institutions that have a significant impact on wider society, whether individually or collectively.

Global Forum for Business Law
The Forum brings together experts from the corporate sector, public practice and academia from around the world to debate trends and developments in business law. One of its areas of special focus is on how legal systems can achieve the right balance between encouraging entrepreneurial initiative and providing necessary protection for stakeholders and the public interest.

www.accaglobal.com/globalforums

This paper outlines ACCA's key messages on shareholders rights in Europe – part of ACCA's campaign to improve corporate governance worldwide.

It sets out how shareholder rights fit into the wider governance agenda and details how the principles of transparency, accountability and long termism can deliver change.

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INTRODUCTION

ACCA believes that recent global crises in the financial sector as well as the LIBOR and Credit Suisse scandals have dented public trust in financial institutions and large corporations. To restore this trust policymakers need to work to strengthen corporate governance worldwide.

The rights and stewardship responsibilities of shareholders have been increasingly under the spotlight and form an important facet of the governance agenda. Shareholders remain the ultimate overseers of effective governance and protecting their rights is a key aspect of this.

In April 2014 the European Commission presented a proposal to the European Parliament and Council for the revision of the existing *Shareholder Rights Directive (Directive 2007/36/EC).*[1] The proposal aims to tackle corporate governance shortcomings relating to listed companies as exposed by recent financial crises. ACCA broadly welcomes the European Commission's proposal as a mechanism for strengthening shareholder rights.

CORPORATE GOVERNANCE

ACCA believes in a wider concept of corporate governance – both its definition and purpose. ACCA views the purpose of corporate governance as being:

- to ensure that the board, as representatives of the enterprise's owners, protects resources and allocates and directs them to make sustained and sustainable progress towards the enterprise's defined purpose
- to ensure that those governing and managing an enterprise account appropriately to its stakeholders on their performance in relation to the defined purpose, and
- to ensure that shareholders and, where appropriate, other stakeholders can and do hold boards to account for their performance.

ACCA believes there are broad links between corporate governance, performance and sustainable value creation and sees shareholder rights as only one piece of the wide promotion of a healthy corporate culture. Arguably, good corporate governance is necessary to promote the interest of wider society, not just that of shareholders.

ACCA therefore cautions against using this revision as a mechanism for addressing wider stakeholder rights issues such as employee engagement. These are important but distinct issues that would be addressed more appropriately through other EU policy initiatives. This should ideally be stated in the Directive's preamble.

The Directive addresses three key principles upon which successful corporate governance relies. These are accountability, transparency and sustainability. ACCA is pleased that these issues are tackled within the Commission proposal but urges the European Parliament and EU Member States to go further in ensuring that these standards are effectively implemented and successfully built upon.

1. *Proposal for a directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement*, European Commission, 2007. <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014PC0213&from=EN>.

These three principles are key to successful shareholder engagement:

- **accountability** through shareholder involvement in the incentives and motivations that drive behaviour
- **transparency** through measures that open the value chain to scrutiny
- **long-term sustainability** of business through maintaining the interests of both shareholders and wider stakeholders.

Governance practice can best be improved by companies providing better explanations of how they apply good practice governance principles, which shareholders should then use as a basis for more informed engagement. This way, shareholders can become more effective in holding boards to account, thus helping them to steer their companies to success.

ACCOUNTABILITY

Remuneration policy and report

ACCA agrees that shareholders should have the right to approve the remuneration policy and report of company directors, which is an instrument of accountability, as advocated in the directive under Articles 9a and 9b.

While it is true that regulation of internal company affairs should be proportionate, the financial crisis revealed that too many companies sought short-term profit at the expense of responsible and sustainable management policies and practices. Accordingly, it seems reasonable for the European Commission to act in the public interest by mandating that pay policies be aligned systematically with the long-term interests of the company. This should be seen as a reasonable additional safeguard for shareholders who recognise that, currently, the owners of a company have little influence on how a company's directors reward themselves. It is also consistent with the overriding policy concern for businesses to be run in a way that focuses on their own long-term interests and those of their investors and employees.

In ACCA's view a statutory requirement for a board policy on pay, and for this to be subject to a shareholder-approval process, will not in itself result in a downward influence on pay. Institutional investors should be expected to support policies that provide incentives for individuals and bring about successful performance on the part of the company but to be aware also of the wider, long-term impact of this policy. There is a strong body of evidence that suggests pay policy and performance targets can have a pernicious effect on short term and dysfunctional behaviour.[2]

ACCA welcomes the Commission's proposal that shareholders should have a binding vote on pay. Nonetheless, the UK experience is that shareholders have yet to vote against any binding pay policies. ACCA therefore advocates that article 9a should go further by highlighting the ratio between fixed and variable pay and communicate the maximum possible package for any one director. This additional element of transparency would reassure stakeholders that companies are acting in their interest and the long-term interest of the business. This should be binding on the company so as to ensure maximum shareholder influence and board accountability. This article could also go further by suggesting policy mechanisms that give preference to those who hold shares over the long term. The Directive should also make clear that these measures also relate to non-financial incentives.

TRANSPARENCY

Stakeholder engagement

The principle of transparency is critical to improving stakeholder engagement, increasing public value and as an effective nudge towards improving corporate practice. We believe that the principle of transparency should remain at the heart of this legislation. By way of example, Integrated reporting is a valuable tool to be used in the provision of a broad range of knowledge and information to investors.

ACCA welcomes the Directive's focus on shareholder engagement and, in particular, supports the engagement of shareholders in voting on key business decisions and the need for a shareholder engagement policy. ACCA also supports measures to improve shareholder identification, the principle of cost-free voting and voting on transactions above 5% of the company's assets.

Cross border voting

As a global organisation, ACCA understands and welcomes the opportunity for enhancing cross-border voting rights and believes that removing barriers to exercising these rights wherever possible will improve capital flows across Europe and the globe. Transaction fees remain a substantial barrier to enhancing engagement and ACCA welcomes the focus on the removal of fees for the simple provision of information.

Shareholder identification

ACCA specifically supports Article 3a, which calls for the identification of shareholders and would support an additional clause prohibiting fees for the provision of this information. Where the Directive seeks to impose a minimum holding for this information to be made available, the level should be set at 3% and it should be made as easy as is practical for the information to be made available. The proposal should also include an appropriate timeframe for the transfer of information of at least five days.

There should be explicit reference in article 3d to not charging for the exercising of voting rights to ensure that this does not become a barrier to transparency. In the longer term, further reform is needed in relation to this issue. EU

2. *Lab Project Report: Reporting of Pay and Performance*, FRC, 2013. <https://frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/Lab-project-report-Reporting-of-pay-and-performanc.aspx>.

decision makers need to take more steps to ensure that institutional investors, who currently dominate 70% of the market,[3] are charged with accurately representing the views of beneficiaries. This is an aim that, given technological advances, should not be out of reach.

LONG-TERM SUSTAINABILITY

ACCA supports the promotion of the interests of long-term shareholders outlined in the Directive. The EU should ensure that long-term value adding companies continue to prosper under this proposal. Both the long-term sustainability of companies and the wider economy should remain the focus of this proposal. Recent events have demonstrated that shareholders have too little influence over the executive of major corporations. Individual shareholders, particularly through their pensions, are investing for the long term and it is an important facet of a free market democracy to have plentiful shareholders who have a stake in investing in successful businesses.

ACCA's research[4] has consistently pointed to the need for companies to demonstrate added value by using integrated reporting. This too gives shareholders greater insight into the value of companies to society in the long term.

Engagement policy

In this context, ACCA specifically supports the need for each publicly listed company to publish an engagement policy setting out how long-term shareholder interest is integrated into company strategy. This will add to the necessary incentives for good governance which ACCA's research[5] shows are key to making this effective. This will not be disproportionately costly and will increase the opportunity for wider stakeholders to participate in this process.

Arguably, the Directive could go further by increasing voting rights for those who hold shares in the long term, although this would admittedly place a potential burden on companies. ACCA would welcome further debate to identify effective mechanisms and incentives for achieving this.

ACCA would also encourage the EU Institutions to ensure that companies detail their long-term benefit to society through the use of new types of reporting. This could be embedded in company practice through Member State interpretation of this directive.

A new approach

ACCA would also like to note the continuing development of the 'comply or explain' principle which the draft Directive refers to several times. ACCA welcomes the work already undertaken at EU and national levels on the issue and looks forward to the publication by the European Commission of its assessment of the effectiveness of the principle.

Recent global developments in corporate governance include a new focus on the implementation and the quality of response rather than simple 'box ticking'. Therefore, ACCA is reviewing the 'comply or explain' principle, in light of emerging practice, to see if it could benefit from being modified to read 'apply and explain'.

Given the Directive's emphasis on quality of engagement, the emerging formulation 'apply and explain' may give better expression to the Commission's long-term vision of thoughtful implementation, above and beyond compliance with the letter of the law.

This view builds on experience from the UK, which generated ideas subsequently adapted and used in the Netherlands. Significantly, it is also supported by the King III Review in South Africa, which included extensive research into global best practice and is considered by many to be a benchmark for excellence. The terminology has also been used in markets such as Malaysia and there is a view emerging globally that the emphasis on actions and principles leads to more effective but also flexible and measurable compliance.

SUMMARY OF POLICY RECOMMENDATIONS

- The Directive should be recognised as part of the European Commission's wider package of corporate governance reform. The proposal will be most effective by concentrating measures on the shareholders sphere.
- The Directive should enhance transparency by highlighting the ratio of fixed to variable pay and reveal a maximum possible package for any one director.
- The Directive should support the principle of cost-free voting and ensure that costs for information relating to the identification of shareholders should not be passed on to clients.
- The Directive should include effective measures that provide incentives for long-term shareholding.

3. Serdar Çelik and Mats Isaksson, 'Institutional Investors and Ownership Engagement', *Financial Market Trends* [OECD Journal], 2013/2, 93–114. <http://www.oecd.org/corporate/Institutional-investors-ownership-engagement.pdf>.

4. *Reporting Pre- and Post-King III: What's the Difference?* ACCA, 2012. <http://www.accaglobal.com/content/dam/acca/global/PDF-technical/integrated-reporting/tech-tp-wtd.pdf>.

5. *Culture and Channelling Corporate Behaviour: Summary of Findings*, ACCA, 2014. <http://www.accaglobal.com/content/dam/acca/global/PDF-technical/corporate-governance/tech-tp-caccb.pdf>.

ACCA'S 10 CORPORATE GOVERNANCE PRINCIPLES

The principles set out below are matters that ACCA argues are fundamental to all systems of corporate governance that aspire to being the benchmark of good practice. They are intended to be relevant to all sectors globally, and to any organisation having a significant degree of separation between ownership and control. Many of these principles are also relevant to organisations where ownership and control lie with the same people.

1. Boards, shareholders and stakeholders should share a common understanding of the purpose and scope of corporate governance and how performance is measured.

2. Boards should be effective and lead by example.

3. Boards should be responsible for the management of risk and ensure that their strategy actively considers both risk and reward over time.

4. Boards should encourage diversity of thinking when making decisions.

5. Board and executive remuneration should promote enterprise performance and be transparent.

6. Boards should account to shareholders and, where appropriate, other stakeholders for their stewardship.

7. Shareholders and other significant stakeholders should hold boards to account.

8. Corporate governance should evolve and improve over time.

9. An additional principle for major public interest entities:
   'the governance of an enterprise should reflect the enterprise's wider role in economies and society'.

10. An additional principle for governments, regulators and supervisors: 'policies on corporate governance should promote creation of sustainable value throughout the economic system'.

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